Town of Westford
Strategic Planning Event
June 20, 2013
Finance Discussion

UNDERSTANDING RETIREMENT COSTS

Retirement costs have been rising for the Town of Westford and across the Commonwealth. Following are some basic facts and information to help citizens understand this complicated and sometimes controversial topic.

HOW IS THE RETIREMENT SYSTEM FUNDED?

The retirement system is funded through three sources:

1. Local Assessments or "Employer Share"

The Town of Westford is assessed their share of the retirement costs for Westford employees and retirees annually. The annual assessment is based on an actuarial valuation performed by Segal for the Middlesex County Retirement System every other year. The last actuarial valuation was completed in 2013 using calendar 2011 information and set the assessment for 2014 and 2015. Our own employees, retirees, rates of compensation, early retirement, disability, mortality rates etc. determine our share of the overall system's cost.

2. Employee Contributions

Employees contribute a % of their regular compensation, based on their date of hire as follows:

Hire Date Prior to 1/1/1975	5%
After 1/1/1975 and prior to 1/1/1984	7%
After 1/1/1984, and prior to 7/1/1996	8%
After 1/1/1996	9%

In Addition to these percentages, all employees hired after 1/1/1979 contribute an additional 2% of compensation in excess of $30,000 per year.

3. Return on Investments

The current actuarial rate of return used by the Middlesex Retirement System is 8%, down from the previous rate of 8.125. The rate is reviewed every 2 years. Further reductions are under consideration.

WHAT IS DRIVING THE COST INCREASE?

The most significant factor is the dramatic change in return on investments. The first investment deficit occurred in 2000 and continued for 2001 and 2002. The actual return rate was .24%, -2.14% and -4.49% respectively. The actuarial rate of return at that time was 8.25%. In the five year period prior to that, the system's actual rate of return averaged 14.55%. The second substantial event occurred in 2008. In 2008 the system experienced an investment loss of -24.50%. Add to that the 8.25% increase that was projected and you have a whopping 32.75% return deficit to absorb! Investment losses are smoothed over a 5 year period when the actuarial valuation is calculated. This usually helps to minimize spikes in local assessments and allows good years to offset bad years in a normal investment environment. It is safe to say that the investment environment has been far from normal for several years now and will continue to be a major factor in our assessments. Other factors contribute to our assessment to a lesser degree. They are as follows:

- Retirement experience (earlier or later than expected)
- Mortality (more or fewer deaths than expected)
- The number of disability retirements, and
- Salary increases different than assumed increases

WHAT IS "UNFUNDED PENSION LIABILITY"?

Local assessments are made up of three parts; Unfunded Pension Liability, Normal Cost and Early Retirement Incentive (ERI). Westford's most recent assessment was made up of 65% Unfunded Pension Liability, 30% Normal Cost and 5% ERI.

Unfunded Pension Liability – The unfunded liability is described as the "single sum value of lifetime benefits to existing pensioners". This is the projected cost for providing pension benefits as defined to existing retirees and beneficiaries based on actuarial assumptions.

How did we end up with such large unfunded balances?

Insufficient member contributions through the 1970s and early 1980s, insufficient employer share contributions during years of market gains and reluctance to decrease actuarial investment rate assumptions. Additionally, some very well publicized loop holes existed in the pension law that allowed some retirees benefits that were not adequately funded through employee contributions or employer contributions on a pay as you go basis. Over many years of operation, retirement systems in Massachusetts were not required to calculate or fund the projected "unfunded liability". When that changed in the 1980s, systems were given until June 30, 2028 to become fully funded. Many systems were prepared to be funded before that deadline. But, the early 2000's stock market collapse set many systems back and so we began to see local assessments rising. Pension reform began to happen in 2009. Changes continued through 2010 and 2011 to try to reduce the growing problem of unfunded liability. One of the changes pushed off the mandatory funding date from 2028 to 2040 to give towns relief from the burden. The pension law reforms will create positive changes, but it will take years before the effect of the changes creates a measureable difference in local assessments.

Normal Cost – Described as the "amount of contributions required to fund the benefit allocated to the current year of service". This refers to the contributions made by the town for currently working employees who are still contributing to the retirement system. When the last actuarial valuation was performed the "Normal Cost" represented 4.74% of payroll.

ERI or Early Retirement Incentive – Is the extra assessment charged to the town for a finite period of time to pay for the cost of allowing a person to retire under an early retirement incentive program. Usually savings are realized in other areas of the town's budget that offset the cost of ERI. All of the Town's ERI assessments will be paid off by 2023.

WHAT CHANGES HAVE BEEN MADE THROUGH PENSION LAW REFORM?

- Eliminated one day for one year service for elected officials
- Elected officials must serve ten years to become vested
- Eliminated working out of grade disability calculations
- Increased minimum retirement age and maximum benefit age
- Retirement calculation is now based on an average of highest 5 years instead of highest 3 years
- Capped pension earnings
- Refined the description of "regular compensation"
- Extended full funding of the retirement system to 2040-the Middlesex target is 2035